

Code of Federal Regulations  
 Title 26. Internal Revenue  
 Chapter I. Internal Revenue Service, Department of the Treasury  
 Subchapter A. Income Tax  
 Part 1. Income Taxes (Refs & Annos)  
 Normal Taxes and Surtaxes  
 Computation of Taxable Income  
 Additional Itemized Deductions for Individuals

## 26 C.F.R. § 1.221-1, Treas. Reg. § 1.221-1

§ 1.221-1 Deduction for interest paid on qualified education loans after December 31, 2001.

Currentness

**(a) In general—(1) Applicability.** Under [section 221](#), an individual taxpayer may deduct from gross income certain interest paid by the taxpayer during the taxable year on a qualified education loan. See paragraph (b)(4) of this section for rules on payments of interest by third parties. The rules of this section are applicable to periods governed by [section 221](#) as amended in 2001, which relates to deductions for interest paid on qualified education loans after December 31, 2001, in taxable years ending after December 31, 2001, and on or before December 31, 2010. For rules applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002, see [§ 1.221-2](#). Taxpayers also may apply [§ 1.221-2](#) to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. To the extent that the effective date limitation (sunset) of the 2001 amendment remains in force unchanged, [section 221](#) before amendment in 2001, to which [§ 1.221-2](#) relates, also applies to interest due and paid on qualified education loans in taxable years beginning after December 31, 2010.

**(2) Example.** The following example illustrates the rules of this paragraph (a). In the example, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The example is as follows:

**Example.** Effective dates. Student A begins to make monthly interest payments on her loan beginning January 1, 1997. Student A continues to make interest payments in a timely fashion. However, under the effective date provisions of [section 221](#), no deduction is allowed for interest Student A pays prior to January 1, 1998. Student A may deduct interest due and paid on the loan after December 31, 1997. Student A may apply the rules of [§ 1.221-2](#) to interest due and paid during the period beginning January 1, 1998, and ending January 20, 1999. Interest due and paid during the period January 21, 1999, and ending December 31, 2001, is deductible under the rules of [§ 1.221-2](#), and interest paid after December 31, 2001, is deductible under the rules of this section.

**(b) Eligibility—(1) Taxpayer must have a legal obligation to make interest payments.** A taxpayer is entitled to a deduction under [section 221](#) only if the taxpayer has a legal obligation to make interest payments under the terms of the qualified education loan.

**(2) Claimed dependents not eligible—(i) In general.** An individual is not entitled to a deduction under [section 221](#) for a taxable year if the individual is a dependent (as defined in [section 152](#)) for whom another taxpayer is allowed a deduction

(v) **Refinanced and consolidated indebtedness**—(A) In general. A qualified education loan includes indebtedness incurred solely to refinance a qualified education loan. A qualified education loan includes a single, consolidated indebtedness incurred solely to refinance two or more qualified education loans of a borrower.

(B) Treatment of refinanced and consolidated indebtedness. [Reserved]

(4) **Examples.** The following examples illustrate the rules of this paragraph (e):

**Example 1.** Eligible educational institution. University F is a postsecondary educational institution described in section 481 of the Higher Education Act of 1965. The U.S. Department of Education has certified that University F is eligible to participate in federal financial aid programs administered by that Department, although University F chooses not to participate. University F is an eligible educational institution.

**Example 2.** Qualified higher education expenses. Student G receives a \$3,000 qualified scholarship for the 2003 fall semester that is excludable from Student G's gross income under section 117. Student G receives no other forms of financial assistance with respect to the 2003 fall semester. Student G's cost of attendance for the 2003 fall semester, as determined by Student G's eligible educational institution for purposes of calculating a student's financial need in accordance with section 472 of the Higher Education Act, is \$16,000. For the 2003 fall semester, Student G has qualified higher education expenses of \$13,000 (the cost of attendance as determined by the institution (\$16,000) reduced by the qualified scholarship proceeds excludable from gross income (\$3,000)).

**Example 3.** Qualified education loan. Student H borrows money from a commercial bank to pay qualified higher education expenses related to his enrollment on a half-time basis in a graduate program at an eligible educational institution. Student H uses all the loan proceeds to pay qualified higher education expenses incurred within a reasonable period of time after incurring the indebtedness. The loan is not federally guaranteed. The commercial bank is not related to Student H within the meaning of section 267(b) or 707(b)(1). Student H's loan is a qualified education loan within the meaning of section 221.

**Example 4.** Qualified education loan. Student I signs a promissory note for a loan on August 15, 2003, to pay for qualified higher education expenses for the 2003 fall and 2004 spring semesters. On August 20, 2003, the lender disburses loan proceeds to Student I's college. The college credits them to Student I's account to pay qualified higher education expenses for the 2003 fall semester, which begins on August 25, 2003. On January 26, 2004, the lender disburses additional loan proceeds to Student I's college. The college credits them to Student I's account to pay qualified higher education expenses for the 2004 spring semester, which began on January 12, 2004. Student I's qualified higher education expenses for the two semesters are paid within a reasonable period of time, as the first loan disbursement occurred within the 90 days prior to the start of the fall 2003 semester and the second loan disbursement occurred during the spring 2004 semester.

**Example 5.** Qualified education loan. The facts are the same as in Example 4 except that in 2005 the college is not an eligible educational institution because it loses its eligibility to participate in certain federal financial aid programs administered by the U.S. Department of Education. The qualification of Student I's loan, which was used to pay for qualified higher education expenses for the 2003 fall and 2004 spring semesters, as a qualified education loan is not affected by the college's subsequent loss of eligibility.

**Example 6.** Mixed-use loans. Student J signs a promissory note for a loan secured by Student J's personal residence. Student J will use part of the loan proceeds to pay for certain improvements to Student J's residence and part of the loan proceeds to pay qualified higher education expenses of Student J's spouse. Because Student J obtains the loan not solely to pay qualified higher education expenses, the loan is not a qualified education loan.

**(f) Interest—(1) In general.** Amounts paid on a qualified education loan are deductible under [section 221](#) if the amounts are interest for Federal income tax purposes. For example, interest includes—

(i) Qualified stated interest (as defined in [§ 1.1273-1\(c\)](#)); and

(ii) Original issue discount, which generally includes capitalized interest. For purposes of [section 221](#), capitalized interest means any accrued and unpaid interest on a qualified education loan that, in accordance with the terms of the loan, is added by the lender to the outstanding principal balance of the loan.

**(2) Operative rules for original issue discount—(i) In general.** The rules to determine the amount of original issue discount on a loan and the accruals of the discount are in [sections 163\(e\)](#), [1271](#) through [1275](#), and the regulations thereunder. In general, original issue discount is the excess of a loan's stated redemption price at maturity (all payments due under the loan other than qualified stated interest payments) over its issue price (the amount loaned). Although original issue discount generally is deductible as it accrues under [section 163\(e\)](#) and [§ 1.163-7](#), original issue discount on a qualified education loan is not deductible until paid. See paragraph (f)(3) of this section to determine when original issue discount is paid.

**(ii) Treatment of loan origination fees by the borrower.** If a loan origination fee is paid by the borrower other than for property or services provided by the lender, the fee reduces the issue price of the loan, which creates original issue discount (or additional original issue discount) on the loan in an amount equal to the fee. See [§ 1.1273-2\(g\)](#). For an example of how a loan origination fee is taken into account, see Example 2 of paragraph (f)(4) of this section.

**(3) Allocation of payments.** See [§§ 1.446-2\(e\)](#) and [1.1275-2\(a\)](#) for rules on allocating payments between interest and principal. In general, these rules treat a payment first as a payment of interest to the extent of the interest that has accrued and remains unpaid as of the date the payment is due, and second as a payment of principal. The characterization of a payment as either interest or principal under these rules applies regardless of how the parties label the payment (either as interest or principal). Accordingly, the taxpayer may deduct the portion of a payment labeled as principal that these rules treat as a payment of interest on the loan, including any portion attributable to capitalized interest or loan origination fees.

**(4) Examples.** The following examples illustrate the rules of this paragraph (f). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The examples are as follows:

**Example 1.** Capitalized interest. Interest on Student K's loan accrues while Student K is in school, but Student K is not required to make any payments on the loan until six months after he graduates or otherwise leaves school. At that time, the lender capitalizes all accrued but unpaid interest and adds it to the outstanding principal amount of the loan. Thereafter, Student K is required to make monthly payments of interest and principal on the loan. The interest payable on the loan, including the capitalized interest, is original issue discount. See [section 1273](#) and the regulations thereunder. Therefore, in determining the total amount of interest paid on the loan each taxable year, Student K may deduct any payments that [§ 1.1275-2\(a\)](#) treats as payments of interest, including any principal payments that are treated as payments of capitalized interest. See paragraph (f)(3) of this section.

**Example 2.** Allocation of payments. The facts are the same as in Example 1, except that, in addition, the lender charges Student K a loan origination fee, which is not for any property or services provided by the lender. Under [§ 1.1273-2\(g\)](#), the loan